

Message Text

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PAGE 01 ROME 12427 01 OF 02 061547Z
ACTION EUR-12

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-05 H-01 INR-10
L-03 NSAE-00 NSC-05 PA-01 SP-02 SS-15 ICA-11
CEA-01 STR-07 AID-05 COME-00 EB-08 FRB-03 XMB-02
OPIC-03 LAB-04 SIL-01 OMB-01 /101 W
-----032754 061626Z /45

R 061310Z JUL 78
FM AMEMBASSY ROME
TO SECSTATE WASHDC 4039
TREAS DEPT WASHDC
INFO AMEMBASSY BRUSSELS
AMCONSUL FLORENCE
AMCONSUL GENOA
AMCONSUL MILAN
AMCONSUL NAPLES
AMCONSUL PALERMO
AMCONSUL TRIESTE
AMCONSUL TURIN

LIMITED OFFICIAL USE SECTION 1 OF 2 ROME 12427

USEEC

E.O. 11652: N/A
TAGS: EFIN, PINT, IT
SUBJ: CONTINUED DELAY IN FORMULATING ECONOMIC POLICIES

1. SUMMARY. THE GOVERNMENT HAS BEEN ENDEAVORING EVER SINCE ITS FORMATION IN MARCH TO FORMULATE AND IMPLEMENT A SERIES OF MEASURES TO REDUCE THE BUDGETARY DEFICIT, THE MOST PRESSING ECONOMIC PROBLEM FACING THE COUNTRY TODAY. DESPITE LARGE AREA OF AGREEMENT IN PRINCIPLE AMONG POLITICAL FORCES--IN PARTICULAR AMONG THE FIVE PARTIES SUPPORTING THE GOVERNMENT--THE GOVERNMENT HAS FAILED TO OBTAIN NECESSARY SUPPORT FOR SPECIFIC MEASURES. END SUMMARY.

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PAGE 02 ROME 12427 01 OF 02 061547Z

2. REDUCTION OF BUDGET DEFICIT IS CURRENTLY VIEWED LAREGLY AS EXPENDITURE-CUTTING EXERCISE. WHILE TAX COLLECTION HAS BEEN INCREASED SIGNIFICANTLY IN THE PAST TWO YEARS AND SOME PUBLIC TARIFF INCREASES HAVE BEEN INTRODUCED, MAIN FOCUS NOW IS NECESSARILY ON EXPENDITURE SIDE. KEY ISSUE HAS BEEN REFORM OF PENSION SYSTEM, WHICH BY ALL

CALCULATIONS NOT ONLY PRODUCES INCREASES IN BENEFITS AT RATE FASTER THAN COST OF LIVING RISES BUT THREATENS ASTRONOMICAL INCREASES IN ABSOLUTE TERMS. THE DEFICIT THIS YEAR IS ESTIMATED AT ABOUT \$5.0 BILLION. EFFORTS ARE ALSO BEING MADE TO REDUCE EXPENDITURES IN AREAS OF HEALTH AND LOCAL GOVERNMENT FINANCE.

3. THESE AREAS HAVE BEEN UNDER CONTINUOUS REVIEW, STUDY AND DISCUSSION. MEETINGS HAVE BEEN HELD AMONG INTERESTED GOVERNMENT MINISTRIES, IN THE CABINET, AMONG THE FIVE PARTIES SUPPORTING THE GOVERNMENT AT VARIOUS LEVELS (ECONOMIC EXPERTS, PARTY VICE SECRETARIES, PARTY SECRETARIES) AND BETWEEN THE GOVERNMENT AND LABOR. UP TO NOW, HOWEVER, THESE EFFORTS HAVE YIELDED VIRTUALLY NOTHING.

4. REASONS FOR LACK OF SUCCESS FIT INTO THREE CATEGORIES:

(A) POLITICAL FORCES HAVE HAD TO FACE MANY (DISTRACTIONS," AND PROSPECT IS FOR MORE OF THE SAME IN COMING WEEKS. FIRST CAME MORO KIDNAPPING AND SUBSEQUENT ASSASSINATION. THEN THE LOCAL ELECTIONS AND CAMPAIGN FOR THE REFERENDA AND, FINALLY, LEONE'S RESIGNATION AND ELECTION OF A NEW PRESIDENT. THE RESOLUTION OF THE PRESIDNETIAL ELECTION COULD LEAD TO A NEW POLITICAL CRISIS AND POSSIBLY NEW PARLIAMENTARY ELECTIONS.

(B) GOVERNMENT REMAINS IN OFFICE AT SUFFERANCE OF A VERY LOOSE "COALITION" OF FIVE POLITICAL PARTIES. THUS, LIMITED OFFICIAL USE

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PAGE 03 ROME 12427 01 OF 02 061547Z

IT HAS NO REAS ALTERNATIVE TO SEEKING AND OBTAINING THEIR CONCURRENCE IN MEASURES IT PROPOSES TO INTRODUCE AND ADOPT. RELATED TO THIS IS IMPORTANT ROLE PLAYING BY LABOR UNIONS IN FORMATION OF POLICY. WHILE THEY DO NOT HAVE ANY FORMAL VETO, THEIR PASSIVITY IS MINIMUM REQUIRED UNDER THE CIRCUMSTANCES.

(C) MOST IMPORTANTLY, ISSUES INVOLVED ARE COMPLEX AND HAVE DIRECT POLITICAL EFFECTS. TO BE MORE SPECIFIC, MEASURES LIMITING EXISTING PENSION BENEFITS WOULD ADVERSELY AFFECT CONSIDERABLE SEGMENT OF ELECTORATE. POLITICAL PARTIES, NOT UNNATURALLY, ARE QUITE RELUCTANT TO TAKE MEASURES WHICH WILL COST THEM POLITICAL SUPPORT.

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PAGE 01 ROME 12427 02 OF 02 061539Z
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LIMITED OFFICIAL USE SECTION 2 OF 2 ROME 12427

USEEC

5. ABSENCE OF CONSENSUS ON THESE ISSUES PERVADES ALL
DECISION-MAKING GROUPS. CERTAINLY IT IS BY NO MEANS CLEAR
THAT CONSENSUS EXISTS WITHIN CHRISTIAN DEMOCRATIC PARTY
(DC). INDEED, AS TREASURY MINISTER PANDOLFI ASSERTED TO
THE AMBASSADOR, THERE ARE STRONG POLITICAL FORCES WITHIN
DC WHICH DO NOT WISH TO TAKE STEPS THAT WOULD PENALIZE
THOSE WHO SHOWED THEIR SUPPORT FOR THE DC IN RECENT
ADMINISTRATIVE ELECTIONS. HOWEVER, THIS LACK OF CONSENSUS
IS ALSO QUITE EVIDENT WITHIN OTHER POLITICAL PARTIES AS
WELL AS AMONG THEM.

6. DIFFUSION OF DECISION-MAKING PARTICIPANTS HAS RESULTED
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PAGE 02 ROME 12427 02 OF 02 061539Z

IN INORDINATE NUMBER OF MEETINGS AND DECISION-MAKING
GROUPS. BANK OF ITALY GOVERNOR BAFFI DESCRIBED PROCESS
TO AMBASSADOR AS A "TRUNCATED PYRAMID." ANDREOTTI'S
ECONOMIC ADVISOR CAPPUGI WENT EVEN FURTHER. HE TOLD
EMBASSY THAT DECISIONS HAVE TO BE SIFTED THROUGH TOO
MANY GROUPS--INTER-MINISTERIAL, POLITICAL PARTIES, LABOR
UNIONS--WHICH NOT ONLY COMPLICATE MATTERS BUT INVARIABLY
LEAD TO WATERED-DOWN ACTIONS FAR FROM THE ORIGINAL INTENT.

7. IT IS DIFFICULT TO GAUGE WHAT SUCCESS GOVERNMENT WILL HAVE IN COMING WEEKS IN MOVING ECONOMIC POLICY OFF DEAD CENTER. PROSPECTS ARE NOT PARTICULARLY GOOD, IN VIEW OF PRESIDENTIAL ELECTION AND EXPECTED AFTERMATH AND OF DIVERGENT INTERESTS INVOLVED IN ECONOMIC ISSUES. HOWEVER, DANGERS TO ITALY OF CONTINUED SLIPPAGE ARE QUITE CLEAR. CURRENT PROJECTIONS FOR THE BUDGET DEFICIT (ENLARGED) SHOW A QUANTUM JUMP IN THE NEXT FEW YEARS. AS A PERCENTAGE OF GDP, THIS DEFICIT IS EXPECTED TO GO FROM 12 PERCENT IN 1977 TO 21 PERCENT IN 1981. SINCE IT IS TOO LATE TO DO MUCH ABOUT 1978, THE FOCUS HAS NOW SHIFTED FROM MEASURES AFFECTING 1978 TO THOSE RELATING TO 1979. EVEN FOR 1979, THERE IS LITTLE TIME LEFT. IF INACTION CONTINUES THROUGH THE AUTUMN, IT WILL BECOME INCREASINGLY DIFFICULT TO TAKE MEASURES AFFECTING 1979 EXPENDITURES. UNLESS THE BUDGET DEFICIT IS REDUCED SIGNIFICANTLY OVER THE NEXT FEW YEARS, INFLATION AND THE BALANCE OF PAYMENTS WILL REMAIN AS MAJOR CONSTRAINTS ON THE RESUMPTION OF A FASTER GROWTH RATE SUFFICIENT TO MAKE A DENT IN UNEMPLOYMENT.

8. ALMOST AS IMPORTANT AS THE ECONOMIC EFFECTS OF INACTION ON THE BUDGET DEFICIT IS INCREASING MOOD OF DISSATISFACTION AND UNEASE OVER SITUATION AMONG POLITICAL LIMITED OFFICIAL USE

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PAGE 03 ROME 12427 02 OF 02 061539Z

PARTIES AND LABOR UNIONS. FRUSTRATION OVER GOVERNMENTAL INACTION COULD LEAD TO FURTHER STRESSES ON POLITICAL ARRANGEMENT AND/OR INTRANSIGENCE ON PART OF LABOR UNIONS. IN FACT, LABOR UNIONS ARE PUTTING OUT SIGNALS THAT UNLESS THE GOVERNMENT MOVED QUICKLY AFTER THE PRESIDENTIAL ELECTIONS--PARTICULARLY IN THE AREAS OF EMPLOYMENT OF YOUTH AND THE MEZZOGIORNO--THAT WE MAY SEE A VERY HOT AUTUMN INDEED. GARDNER

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